COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| AN ADJUSTMENT OF GENERAL RATES OF DELTA NATURAL GAS COMPANY, INC. | ) CASE NO. 97-066 |

# O R D E R

IT IS ORDERED that the Attorney General for the Commonwealth of Kentucky ("AG") shall file the original and 15 copies of the following information with this Commission, with a copy to all parties of record, by August 15, 1997. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible.

1. Refer to Direct Testimony of Robert J. Henkes, page 7. Provide any precedents you are aware of to support your proposal to reduce common equity based upon the utility's use of the equity method to account for its investment in its subsidiaries.

2. Refer to pages 8 and 9 of Mr. Henkes testimony. Mr. Henkes states that, "Generally, a utility's return requirement is determined by applying the calculated overall rate of return to the rate base investment, not to the capital structure amount. . . ." Provide documentation to support this statement as it relates to the determination of return requirements for Kentucky jurisdictional utilities.

3. Refer to Henkes Direct Testimony, page 9.

a. Explain why you did not propose to remove the $312,913 in capital cost associated with the Cash Surrender Value of Life Insurance in arriving at your proposed capital structure.

b. Explain how you determined that the Cash Surrender Value of Life Insurance is still in the capital structure. Provide justification for your response.

c. Explain why you did not propose to remove the $5,851,153 in capital cost associated with Deferred Gas costs in arriving at your proposed capital structure.

d. Do you believe there are capital costs associated with deferred gas costs and if so whether these costs should be recovered through the GCR mechanism instead of the base rate as proposed by the utility? Fully explain your answer including a discussion of whether capital costs associated with gas costs should be recovered in any manner, at any time from ratepayers.

4. Refer to Henkes Direct Testimony, page 10. Provide documentation to support your proposal to treat customer deposits as a reduction to rate base. Specifically, this documentation should include a discussion of where these deposits are in the utility's rate base as well as examples of instances in which this Commission has reduced rate base for the customer deposits outstanding.

5. Refer to Henkes Direct Testimony, page 15.

a. Based on the lead/lag or "old" verses "new" nature of CWIP, as discussed in your testimony, explain why the availability of these funds is not inherently a part of the utility's capital requirements considerations.

b. In light of the fact that you have accepted the 1/8th cash working capital requirements formula, provide justification for reducing CWIP by a percentage of the CWIP payables - a methodology that appears to be related to the lead/lag concept of working capital requirements.

c. Explain why you believe it is appropriate to reduce the test year end level of CWIP by 17.5 percent which represents the percentage of actual average CWIP payables to actual average CWIP instead of using test-year-end levels to determine the appropriate percentage reduction.

6. Refer to Henkes Direct Testimony, page 16.

a. Based on the lead/lag or "old" verses "new" nature of materials and supplies, as discussed in your testimony, explain why the availability of these funds is not inherently a part of the utility's capital requirements considerations.

b. In light of the fact that you have accepted the 1/8th cash working capital requirements formula, provide justification for reducing materials and supplies by a percentage of the materials and supplies payables - a methodology that appears to be related to the lead/lag concept of working capital requirements.

c. Explain why it is appropriate to reduce the test-year-end level of materials and supplies by 13.89 percent which represents the percentage of the actual average materials and supplies payables to the actual average materials and supplies instead of using the test-year-end levels to determine the appropriate percentage reduction.

7. Refer to Henkes Direct Testimony, Schedule RJH-3. Explain why you have proposed to use the test-year-end balance instead of a 13 month average for each of the following items:

a. Prepayments.

b. Materials and Supplies.

c. Gas in Storage.

8. Refer to Henkes Direct Testimony, page 18. Provide additional documentation supporting your proposal to remove the $484,500 in ADIT associated with A/C 28302 - Regulatory ITC.

9. Refer to Henkes Direct Testimony, page 19.

a. Do you believe it is ever appropriate to include ADIT associated with alternative minimum taxes in the calculation of a utility's rate base? Fully explain your answer.

b. If the items that give rise to the ADIT resulting from alternative minimum taxes are regulatory in nature, why should they be excluded from the utility's rate base?

10. Refer to Henkes Direct Testimony, page 19. Since the Ferrin debt is related to long-term debt Delta has incurred, and which is included in the proposed capital structure of both Delta and yourself, explain why the ADIT associated with the debt should be removed from the utility's rate base.

11. Refer to Henkes Direct Testimony, page 20. If you remove 12.7 percent of the unadjusted per books ADIT balance to reflect the ADIT allocable to Canada Mountain and you remove the ADIT associated with the Ferrin note as discussed on page 19 of your

testimony, explain how this does not result in a double removal of certain ADIT amounts related to the capital component represented by the Ferrin debt.

12. Refer to Henkes Direct Testimony, page 23.

a. Explain what methodology is employed by Kentucky-American Water Company in determining the cash working capital component of its rate base.

b. Discuss the impact of using the lead/lag methodology as opposed to the 1/8th operating ratio methodology on the need to adjust rate base items for associated payables related to contractor retentions, materials and supplies and construction work in progress.

13. Refer to Henkes Direct Testimony, page 33.

a. Why do you believe it is appropriate to include interest expense associated with customer deposits as an "above the line" operating expense?

b. Provide examples of instances in which this Commission has included interest on customer deposits as an "above the line" operating expense as well as where this Commission has reduced rate base by the amount of customer deposits outstanding.

14. Refer to Henkes Direct Testimony, page 41. Provide documentation to support your position that, as a result of being former officers of Delta, consultation fees paid to Thomas Kohnle and Eunice Yarber totalling $21,371 should be excluded from the reasonable operating expenses of the utility. Specifically, provide cites wherein this Commission has reduced operating expenses for amounts paid to former employees for consulting services and retainers solely on the basis that as former employees they were not independent "outside consultants." Additionally, explain how much time must pass

before a former employee should be compensated for services provided to a previous employer.

15. Refer to Henkes Direct Testimony, page 47. Provide justification to support the use of the so-called "interest synchronization method" to calculate interest expenses deductible for tax purposes. Include with this response a thorough discussion of why this methodology is more appropriate than using the test-year-end debt and debt cost to arrive at the tax deductible interest expense appropriate for rate-making purposes.

16. Refer to Henkes Direct Testimony, pages 46-48 . Explain why you believe it is appropriate to reflect the ITC amortization and the excess deferred tax amortization related tax credits in computing the income tax expense applicable to Delta's current customers.

17. Refer to David H. Brown Kinloch Direct Testimony, pages 24 and 25.

a. Explain why it is inappropriate to grant energy conservation incentives based on the number of gas appliances installed.

b. Provide documentation to support your statement that a furnace with a 78 percent efficiency rating is the lowest efficiency furnace legally manufactured.

c. Provide documentation supporting your statement that a SEER of 8.0 is outdated.

d. Provide documentation to support your statement that the insulation standards required under Delta's energy conservation program are the state's minimum standards.

18. How does the percentage of common equity in Delta's capital structure compare to the common equity percentage of the group of Dr. Weaver's comparable companies?

19. What effect would lowering the common equity percentage, as recommended by Mr. Henkes, have on the relative risk of Delta's capital structure?

20. Does Delta's relatively low dividend impact its cash flow coverage of common dividends ratio? Should it be considered comparable to the other companies in this measure if 7 of the 9 companies pay higher dividends?

21. Page 32 of Dr. Weaver's testimony indicates a DCF cost of equity range of 9.1 to 10.3 percent. How is this range extracted from results shown at the bottom of the page (with a range of 9.47 to 11.48 percent for comparable companies, and 9.86 to 12.21 for Delta)?

22. Dr. Weaver's Yield to Maturity cost of long-term debt for Delta falls within the range of results produced by his CAPM analysis. Is it reasonable to include a number close to the recommended cost of the long-term debt component in an estimate of common equity cost? Explain.

23. Is Dr. Weaver recommending the use of Delta's proposed long-term debt expense of 7.86 percent?

24. Explain the development of the calculations in Exhibit DHBK-4 of David H. Brown Kinloch's testimony, specifically, how the normalization adjustment factors on page 2 of 4 were used to calculate the volume levels on page 3 and 4 of 4.

The following questions refer to Mr. Kinloch's testimony.

25. Refer to A11 on pages 7-8 and Exhibit DHBK-1, page P, lines 43. Provide the calculations supporting your load factor estimation.

26. Refer to Exhibit DHBK-1, page P, lines 17-18. Explain why it is appropriate to include interruptible customers in your calculations.

27. Refer to A12 on page 9 and Exhibit DHBK-1, page P, line 13. Further explain why it is appropriate to include April in your calculations.

28. Refer to lines 7-17 on page 15 and A15 on page 17. Explain why your "corrected" Design-A allocation factor would not now serve as a proper demand allocator, since it clearly allocates some costs to interruptible customers.

Done at Frankfort, Kentucky, this 1st day of August, 1997.

PUBLIC SERVICE COMMISSION

Linda K Breathitt
For the Commission

ATTEST:

Don Mills
Executive Director